

THE DEVELOPMENT OF ENERGY RESOURCES IN CENTRAL ASIA

HEARING BEFORE THE SUBCOMMITTEE ON EUROPE, EURASIA, AND EMERGING THREATS OF THE COMMITTEE ON FOREIGN AFFAIRS HOUSE OF REPRESENTATIVES ONE HUNDRED THIRTEENTH CONGRESS SECOND SESSION

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WEDNESDAY, MAY 21, 2014

HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON EUROPE, EURASIA, AND EMERGING THREATS,
COMMITTEE ON FOREIGN AFFAIRS,
Washington, DC.

The subcommittee met, pursuant to notice, at 2 o'clock p.m., in room 2200 Rayburn House Office Building, Hon. Dana Rohrabacher (chairman of the subcommittee) presiding.

Mr. ROHRABACHER. I call this subcommittee hearing to order. The subject of today's hearing is the development of energy resources in Central Asia. Without objection, all members will have 5 legislative days to submit additional written questions or extraneous material for the record.

Natural resources including gas and oil are the building blocks of a nation's economic strength and we all depend on these energy resources to power industry, heat homes, bring us our food and other goods. Natural resources can, if put to good use, elevate the human condition and reduce poverty. That is, if it is put to good use.

The planet's scarce resources are distributed unevenly around the globe, so history is filled with accounts of nations, states, and businesses engaged in power plays and maneuvers to secure and to move and to utilize and to sequester natural resources. A contest of resources is playing out right now in Central Asia.

And so this hearing asks the question, what does the future hold for energy resources in Central Asia? To highlight the importance of this topic, it was just announced today that Russia and Communist China agreed on a natural gas deal worth \$400 billion. This is a significant development that takes more gas off the market, and of course this gas otherwise might go to supply Europe.

As many of my colleagues know, I have been warning about the growing military and economic power of Communist China for years. Today, China has grown to become one of the world's largest energy consumers having just signed a gas deal with Russia for \$400 billion. Today, China has grown, as I say, to become the world's largest energy consumer. This makes Central Asia's oil and gas essential to the Chinese Communist Party and their plans. The Communist Party rules their country with an iron fist and it also threatens their neighbors.

The Communist regime is now actively engaged in expanding its influence beyond its western borders and throughout Central Asia.

Their aim is to secure the access to energy resources through long term contracts, investment loans, and building pipelines back to China and perhaps bribes and other things like that, that other under-the-table maneuvers.

Make no mistake, these deals favor the corrupt leaders of the Communist Chinese party, it solidifies their grip, and will not necessarily benefit the vast majority of the people of Central Asia. During the last decade, trade between China and the region has increased 30-fold and continues to climb. This is happening as the spectacle of China's worldwide effort to fence off critical natural resources from the West through bribes and intimidations continues and is quite evident.

America's challenge is to find and to implement policies which promote political progress, support the sovereignty of five Central Asian countries, and allow their energy and other natural resources to be exported in a strategically and economically beneficial way. That is no easy task. This is made more difficult by our withdrawal from Afghanistan.

While it is good that our troops are coming home, I worry that the attention that Washington has paid to the region will actually dissipate once our military is gone. And we have not had a level of, actually, involvement that I think would be healthy for our country and for the West to begin with, but once our troops are gone from Afghanistan that attention paid to by our Government and our country and our people may even go beyond what we are facing today which is unacceptable at today's level. And with that China's ruling clique will win its quest for domination of that region of the world by default.

I look forward to hearing from our excellent panel of witnesses on how the U.S. can be proactive in the region. I am specifically interested in learning more about the possibility of a trans-Caspian pipeline and the potential which holds to increase Europe's energy security and at the same time further global economic progress.

With that I turn to my ranking member, Mr. Keating, for his opening statement.

Mr. KEATING. Well, thank you, Mr. Chairman, for holding this timely meeting. Today's hearing topic provides us with an opportunity to examine the global impact of climate change and expanding world population and accompanying social unrest.

In March 2013, for the first time Director of National Intelligence, James Clapper, listed competition and scarcity involving natural resources as a national security threat on a par with global terrorism, cyber war, and nuclear proliferation. A year after the statement was made, the Ukraine crisis in particular has highlighted Europe's energy insecurity and vulnerability tied to overdependence on Russian gas.

European leaders in March of this year concluded that efforts to reduce Europe's dependency should be intensified, and asked the European Commission to propose a comprehensive plan to move toward energy independence by June. I look forward to their findings and believe that Central Asia as well as the Caspian can play an important role in Europe's future strategy, but the threat of Russian aggression in the region remains with us.

Central Asian states have long been pressured by Russia to yield large portions of their energy wealth to Russia, in part because Russia controls most existing export pipelines. Further, Chinese interest in the region is growing as well. Over the past decade, China has dramatically increased its imports from the region. Today, China imports over half of its gas from Turkmenistan. And last week, the Turkmen President presided over the opening of a new processing plant that will further increase the flow of Turkmen gas to China.

Yet even with seemingly competing interests between Russia and China over resources in Central Asia, we have as the chairman mentioned, received the news of \$400 billion gas deal that was signed between the two countries. Of course the devil will be with the detail on that agreement, and reportedly, no details have been finalized. I view this as an interesting time and message from Moscow and Beijing to jointly send.

Unfortunately these are not the type of influences we would like to see in such an energy-rich region, particularly since many of the Central Asian countries themselves have inadequate protections for foreign companies looking to invest. They often lack a robust foundation built on the principle of a rule of law.

I would like to hear from our witnesses today on how the United States can engage with Central Asian governments to improve governance and transparency in their energy sector both bilaterally and through international organizations. However, as we discuss these important issues, I hope that we continue to assist our European partners toward discovering an energy independent future. I believe that the TTIP agreement may provide an opportunity for the EU and the U.S. to address some of these concerns in a mutual manner. I look forward in this regard to hearing from our witnesses, and with that Mr. Chairman, I yield back.

Mr. ROHRABACHER. Well, thank you very much. And we have four witnesses today and I will be introducing all of them now. I would ask each of you to limit your remarks to 5 minutes. You can submit longer statements for the record, but I have to be very ruthless in enforcing this rule because we are going to be in and out of here. And if you take more than 5 minutes you are actually taking time away from one of the other witnesses.

So our first witness today is the Honorable Dennis Shea, the chairman of the U.S.-China Economic and Security Review Commission. He previously served as counsel and deputy chief of staff to Senate Majority Leader Bob Dole. Later he was appointed as executive director of the President's Commission on postal reform and as assistant secretary for policy development at the Department of Housing and Urban Development.

He has earned multiple degrees from Harvard University including his JD. Chairman Shea is currently serving his fourth term as a member of that commission. I want to note that the U.S.-China Commission produces an annual report that is a fantastic source of information about what threat and potentials we have with the Communist Chinese party.

And then we have the next witness, Mr. Charlie Santos. He is an expert in Central Asian affairs, who I have known for many years. From in the late '80s through the mid-'90s, he worked in

various capacities for the United Nations in Central Asia and as well as in Afghanistan. After he left the United Nations, Mr. Santos became the vice president of Centgas consortium helping to negotiate pipeline routes for oil and gas deals in the region.

Over the past 20 years he has held leadership roles in many Central Asian energy ventures, and today as chairman of the Uzbek Investment Group he has a great deal of on the ground experience about the matters we are planning to discuss today.

Next, we have David Merkel. He is a senior fellow at the Atlantic Council here in Washington and a visiting faculty member at the Azerbaijan Diplomatic Academy in Baku. He previously served as the deputy assistant secretary of state for European and Eurasian Affairs, and as the director for the European and Eurasian Affairs for the National Security Council. Before that he was the deputy assistant secretary for International Affairs at the Treasury Department and a senior professional staff member for the Senate Foreign Relations Committee.

Dr. Jeffrey Mankoff is with us as well, and he is the deputy director of the Russian and Eurasia Program at the Center for Strategic and International Studies. He is a frequent commentator on international security matters and the author of the book, "Russian Foreign Policy: The Return of the Great Power Politics."

Before joining the CSIS, he worked as an advisor to the State Department on U.S.-Russian relations. Dr. Mankoff teaches courses on international relations both at Georgetown and Columbia universities. He is a graduate of the University of Oklahoma and holds a PhD from Yale.

Thank all of you for being with us today. We have a very high quality panel to advise us, and you, Mr. Shea, you may move forward with your testimony. And again, if we can keep it at 5 minutes and put the rest in the record, maybe we can everybody's testimony in before the first vote.

STATEMENT OF THE HONORABLE DENNIS C. SHEA, CHAIRMAN, U.S.-CHINA ECONOMIC AND SECURITY REVIEW COMMISSION

Mr. SHEA. Chairman Rohrabacher, Ranking Member Keating, thank you for the opportunity to testify. Before I begin I would like to note that this testimony reflects my personal views and not necessarily the judgments of the entire China Commission.

Over the last decade, China's engagement with its Central Asian neighbors has grown significantly. In a region with a long history of Russian control and influence, China is now the most powerful economic actor and is poised eventually to surpass the United States and Russia as Central Asia's preeminent foreign power.

The Chinese Government is increasing its economic ties with Central Asia particularly in the energy sector for two main strategic reasons. First, Beijing is expanding its energy relationship with Central Asian states as part of a long term energy security strategy designed to diversify the types and sources of energy in an effort to reduce the risk of disruption of supply. Some Chinese policy makers believe this strategy could mitigate China's so-called Malacca dilemma, or vulnerability to other countries imposing a blockade on Chinese trade at critical maritime chokepoints. How-

ever, Chinese growth in oil demand is such that the share of sea-borne imports will increase even if all China's planned overland energy routes are realized.

Second, Beijing seeks to promote the security and development of its Xinjiang Autonomous Region. Beijing judges increased economic ties between China's westernmost region and Central Asia will raise the welfare of the ethnic Uyghurs thereby helping to rein in ethnic unrest in Xinjiang.

China's energy inroads into Central Asia are manifest in oil and natural gas imports transported via pipeline, investment in Central Asian energy companies and projects, and loans to Central Asian countries for energy products and production. All of China's Central Asian hydrocarbon imports are transported via two pipeline networks. The Kazakhstan-China oil pipeline and the Central Asia-China pipeline.

Chinese banks and national oil companies have been heavily involved in the financing, ownership, and operation of these pipelines. For example, Kazakhstan, the region's largest economy and top oil producer has been the primary recipient of Chinese investment in Central Asian oil since 1997. Today, China's largest national oil company is the majority owner of two of Kazakhstan's major oil companies and is involved in several oil exploration and production projects throughout the country.

Chinese companies own so many projects in Kazakhstan that experts estimate China controls between 25 and 50 percent of the country's oil production. Turkmenistan accounts for more than half of China's natural gas imports, and its future share of imports will likely increase with plans to elevate imports from 20 billion cubic meters per year in 2013 to 65 billion cubic meters by 2016.

Since 2009, Chinese state-owned entities have extended at least \$32 billion in loans to finance oil and gas development, production, and exports in Central Asia. During a high profile tour of the region in late 2013, Chinese President Xi Jinping reportedly signed agreements for an additional \$8 billion in loans that will likely also be used to finance energy projects.

Many Central Asian governments welcome China's increasing economic engagement. Chinese investment, trade deals, and loans have enabled economic growth and development. However, Chinese economic engagement in Central Asia can be a double-edged sword. The region's overreliance on energy exports to sustain growth can slow the development of competitive industries and democratic institutions. Additionally, at the local level allegations of poor business behavior by Chinese companies have led to protest and violence against Chinese workers and businesses.

The rise of Chinese influence in Central Asia at the expense of Russia coupled with the probable decline in overall U.S. interests in the region after the planned withdrawal of troops from Afghanistan will likely result in a major shift in the balance of power between the major external actors in favor of China. This shift presents both challenges and opportunities for the United States.

China's energy ties with Central Asia can support U.S. policy efforts to spur economic activity in the region, encourage regional oil and natural gas production, and potentially promote European energy security by weakening Russia's near total control of regional

gas supplies. However, China's no-strings-attached approach to investment can foster official corruption and may provide Chinese state-owned enterprises with an unfair advantage over Western investors. Furthermore, Beijing could leverage its position as the region's most powerful economic actor to derail U.S. policy backed initiatives including initiatives at the United Nations, or certainly undermine U.S. efforts to promote good governance, democracy, and human rights in Central Asia.

Thank you for the opportunity to testify.

[The prepared statement of Mr. Shea follows:]

Testimony of Dennis C. Shea

Chairman, U.S.-China Economic and Security Review Commission

"China's Energy Engagement with Central Asia and Implications for the United States"

for the House Foreign Affairs Subcommittee on Europe, Eurasia, and Emerging Threats

Hearing on "The Development of Energy Resources in Central Asia"

May 21, 2014

Chairman Rohrabacher, Ranking Member Keating, Members of the Subcommittee, thank you for the opportunity to testify today. Before I begin, I would like to note that this testimony reflects my personal views and not necessarily the judgments of the U.S.-China Economic and Security Review Commission.

Over the last decade, China's engagement with its Central Asian neighbors has grown significantly, largely due to Beijing's efforts to boost energy security and enhance stability in China's western provinces. In a region with a long history of Russian control and influence, China now is the most influential and powerful economic actor and is poised to eventually surpass the United States and Russia as Central Asia's preeminent foreign power.

Drivers of China's Increasing Energy Engagement with Central Asia

The Chinese government is increasing its economic ties with Central Asia, particularly in the energy sector, for two main strategic reasons.

First, Beijing is expanding its energy relationship with Central Asian states as part of a multifaceted, long-term energy security strategy. By doing so, China can diversify the types and sources of energy to reduce the risk of disruption from any one supplier. For years, Chinese leaders have viewed the growing reliance on foreign supplies of energy as a vulnerability to the country's economic growth, the cornerstone of the Chinese Communist Party's legitimacy. Underpinning this concern is Beijing's fear that an economic slowdown could destabilize the regime.

In the long term, Central Asian oil and natural gas will fulfill some of China's energy needs, but it will by no means be a game changer for Chinese energy security. Some Chinese policymakers and strategists argue that Central Asian energy imports will lessen China's reliance on seaborne energy, thereby mitigating China's "Malacca dilemma," or vulnerability to potential future efforts by other countries (such as the United States) to blockade Chinese trade at critical maritime chokepoints. This assumption is misguided, however. China's oil demand growth is such that the share of seaborne imports (primarily from Saudi Arabia) will increase even if all China's planned overland energy routes are realized. Moreover, energy supplies transported via Central Asian pipelines are likely to be more expensive and more vulnerable than seaborne supplies to both physical attack by terrorists or other parties and unintentional disruption.¹

*Second, Beijing seeks to promote the security and development of its Xinjiang Autonomous Region.*² Poverty, ethnic tensions, and repressive government policies have led to episodic unrest, engendered political movements for Xinjiang's independence or autonomy from Chinese rule, and sometimes resulted in violence and terrorism. Beijing judges increased economic ties between China's westernmost region and Central Asia will raise the welfare of its Uyghur population, the largest ethnic minority in Xinjiang, thereby helping to rein in ethnic unrest and further assimilate minorities into China's majority ethnic Han society. In 2010, then-President Hu Jintao announced that China would bring Xinjiang residents' per capita GDP up to the national average by 2015.³ Furthermore, China's foreign policy community is publicly debating a grand strategy, known as "Marching Westward," that calls for China to shift its attention from East Asia and "rebalance" its strategic focus to the vast area from Central Asia to the Middle East.⁴

Additionally, Beijing is pursuing broader security interests in Central Asia. China uses its limited, but growing, defense ties in the region⁵ to increase China's influence, decrease regional reliance on the United States for security, counter perceived U.S. efforts to encircle China, and reduce suspected support by Central Asian entities to violent separatists groups in western China.⁶ Nevertheless, China's defense engagement in Central Asia remains secondary to economic engagement as Beijing continues to primarily address its regional security concerns through economic means.

Manifestations of China-Central Asia Energy Ties

China's energy inroads into Central Asia are manifest in oil and natural gas imports transported via pipeline, investment in Central Asian energy companies and projects, and loans to Central Asian countries for energy projects and production.

Trade

China sources most of its oil from the Middle East and Africa. Only about 4 percent of its imported crude comes from Kazakhstan.⁷ Nevertheless, imports from Kazakhstan have doubled from about 5 million tons in 2008 to 12 million tons in 2013⁸ and are growing at a faster rate than China's overall oil imports. China's reliance on Kazakh oil is likely to grow in the future.

Turkmenistan accounts for more than half of China's total natural gas imports,⁹ and its future share of imports will likely increase as well. China and Turkmenistan plan to elevate imports from 20 billion cubic meters per year in 2013 to 65 billion cubic meters by 2016.¹⁰ Uzbekistan, a country rich in natural gas but with little capacity for export, began exporting natural gas to China in 2012.¹¹ In 2013, Uzbekistan supplied 2.1 million metric tons of natural gas to China, a substantial increase over 2012 levels.¹²

All of China's Central Asian hydrocarbon imports are transported via two pipeline networks: the Kazakhstan-China oil pipeline and the Central Asia-China Gas Pipeline, which traverses Turkmenistan, Uzbekistan, Kazakhstan, and China. Kazakhstan delivers oil to China's Xinjiang Autonomous Region via the Kazakhstan-China pipeline, and Turkmenistan and Uzbekistan deliver natural gas to Xinjiang via the Central Asia-China Gas Pipeline. Constructed in only 18 months, the Central Asia-China Gas Pipeline was the fastest built pipeline of its size in history.¹³ Chinese state-owned banks and national oil companies have been heavily involved in the financing, ownership, and operation of these pipelines.

As a trade partner, China is now rivaling Russia in the region. China's trade with Kazakhstan, the region's largest economy, amounted to \$23 billion in 2012, neck-in-neck with Russia's \$24 billion. In 2003, China-Kazakh trade totaled just \$3 billion. Kazakhstan in 2012 sent 18 percent of its total exports to China, almost three times the share it sent to Russia.¹⁴ China has thus become an expedient means for Kazakhstan to earn foreign currency. In the case of Turkmenistan, the region's second-largest economy, the pattern is even starker: the gas producer sent 70 percent of its exports to China in 2012, versus just 2 percent to Russia.¹⁵

Investment

Kazakhstan is Central Asia's dominant oil producer, and in 2012 received two-thirds of all foreign direct investment in the region.¹⁶ Not surprisingly, it has been the primary recipient of Chinese investment in Central Asian oil over the past two decades.¹⁷ China's largest national oil company, China National Petroleum Corporation (CNPC), is the majority owner of two of Kazakhstan's major oil companies (it owns 85.42 percent of AktobeMunaigas and 67 percent of PetroKazakhstan) and is involved in several oil exploration and production projects throughout the country.¹⁸ The company also provides oilfield services in Kazakhstan¹⁹ and plans to build a refinery there.²⁰ China's sovereign wealth fund, China Investment Corporation, also invested almost \$1 billion in Kazakh energy in 2009.²¹ Chinese companies own so many projects (or stakes in projects) in Kazakhstan that experts estimate China controls between 25 and 50 percent of the country's oil production.²²

Chinese investment in Central Asian natural gas is focused on Turkmenistan. Although Turkmenistan has the sixth-largest natural gas reserves in the world, the government's aversion to foreign investment has made it difficult for the country to take full advantage of its energy wealth.²³ China is the only country that has been able to significantly penetrate Turkmenistan's opaque energy sector, and CNPC is the dominant foreign player in its onshore production.²⁴ The Chinese company reportedly has invested \$4 billion in Turkmenistan's Bagtyarlyk project through a 35-year production-sharing agreement. Natural gas from this project supplies the Central Asia-China Gas Pipeline.²⁵ According to the late Alexandros Petersen, former advisor to the European Energy Security Initiative at the Wilson Center, CNPC plans to distribute Turkmen gas from the pipeline to other countries in the region in addition to importing into Xinjiang.²⁶ CNPC is also jointly developing South Yolotan, the second-largest gas field in the world, which eventually will feed into the pipeline as well. This project includes gas processing facilities operated by CNPC.²⁷

Other Central Asian countries hold potential for increased Chinese investments. Tajikistan has not experienced the level of investment of its energy-rich neighbors but may have significant gas resources. By one estimate Tajikistan could possess 114 trillion cubic feet of gas, making it the second-largest reserve of natural gas in Central Asia.²⁸ In 2012, CNPC began exploring Tajik oil and gas potential.²⁹ Another recent development is Chinese investment in Kyrgyzstan. In late 2013, China financed the construction of Kyrgyzstan's first oil refinery, ending that country's complete dependence on Russian oil.³⁰ However, as of February 2014, Kyrgyzstan's prime minister suspended work at the refinery after local residents protested conditions there.³¹

As in the case of trade, China is becoming a more prominent player than Russia on the investment front. According to the Kazakhstan Chamber of Commerce in the United States, Russian investments in Kazakhstan's oil and gas sector are estimated at \$4.5 billion, including some \$1.4 billion in direct investment. Nonetheless, "Russian activities have so far been relatively limited, especially compared to Chinese companies which had consistently increased their share in Kazakhstan's oil and gas sector."³²

Loans

Since 2009, Chinese state-owned entities have extended at least \$32.3 billion in loans to finance oil and gas development, production, and exports in Central Asia. During a high-profile tour of the region late last year, Chinese President Xi Jinping reportedly signed agreements for \$8 billion in additional loans to Kazakhstan.³³ These disbursements are part of China's global "oil-for-loans" strategy: China's two state-run policy banks, China Development Bank and China Export-Import Bank, issue subsidized loans to developing countries in need of cash, and in return, China secures long-term supplies of oil and gas at stable prices. Outside Central Asia, prominent recipients of such loans are Venezuela and Angola – not to mention Russia. For China, "oil-for-loans" deals have several benefits: China builds up a buffer of supplies against the volatile energy market; puts its huge surplus of dollar reserves to effective use; and sells other Chinese goods and services, such as civil engineering work and construction machinery, to the borrowing country as part of the loan.

Oil-for-loans are usually brokered directly with a national government or a state-owned energy company. In Turkmenistan, China Development Bank has loaned \$8.1 billion to Turkmenengaz, the country's national natural gas company, for the development of the South Yolotan gas field. Turkmenengaz is repaying these loans with natural gas exports to China.³⁴ Similarly, China Export-Import Bank has extended \$5 billion to the Kazakh government and CNPC issued \$5 billion to Kazakh national oil company KazakhMunaiGas.³⁵

Concurrently, China's policy banks lend to Chinese companies that do business in the region. China Development Bank, for instance, has financed CNPC's \$4.2 billion purchase of a 20 percent stake in Kazakhstan's PetroKazakhstan; CITIC Group's \$1.9 billion purchase of a Kazakh oilfield; and the \$8.1 billion construction of the Central Asia-China Gas Pipeline.³⁶

Geopolitics can also factor into these loans. The South Yolotan project in Turkmenistan is one example. Turkmen officials sought the loan from China almost immediately after a costly explosion of a pipeline that sends natural gas to Russia. Turkmenistan blamed the explosion on Gazprom, Russia's largest natural gas company. The incident stoked tensions, and Gazprom cut off the flow of Turkmen gas to Russia for

months. That led Turkmenistan to seek ways to diversify its natural gas exports away from Russia and toward China.³⁷

Implications of China's Growing Engagement with Central Asia

Social and Economic Implications

Many Central Asian governments welcome China's increasing economic engagement. Chinese investment, trade deals, and loans have enabled economic growth and development in a low-income area of the world with poor infrastructure and a lack of competitive industries. In Turkmenistan, for example, Chinese engagement has given the country's energy sector a much-needed boost, not just by investing in production but also by bringing Turkmenistan's vast natural resources to market via the Central Asia-China Gas Pipeline.

Chinese economic engagement in Central Asia can be a double-edged sword, however. Some civil society groups and other segments of Central Asian society have charged that Chinese investment and loans primarily serve Beijing's economic interests at the expense of local populations. They have also criticized Chinese enterprises for their poor labor conditions, unfair pay, abuse of local workers, and unsustainable environmental practices. In some countries in Central Asia, resentment of Chinese business practices has led to protests, violence against Chinese workers and businesses,³⁸ and government fines of Chinese organizations.³⁹

Central Asian economies are also growing too dependent on energy exports to sustain growth. The dangers of this one-sided approach are well documented. Changes in global commodity prices can destabilize the domestic economy. Resource windfalls can push up the value of the national currency, driving manufacturers out of business and concentrating the workforce in extractive industries. Most important, wealth and power can become concentrated among a small group of rent-seeking elites.

Geopolitical Implications

The rise of Chinese influence in Central Asia at the expense of Russia, coupled with a probable decline in overall U.S. interest in the region after the planned withdrawal of troops from Afghanistan, is likely to shift the balance of power between the major external actors in China's favor. This shift presents both challenges and opportunities for the United States. China's energy ties with Central Asia support U.S. policy efforts to spur economic activity in the region, encourage regional oil and natural gas production, and promote European energy security by weakening Russia's near-total control of regional gas supplies.⁴⁰

However, China's "no strings attached" approach to investment fosters official corruption and waste, which is already rampant in Central Asian government and commercial sectors. This approach also provides Chinese state-owned and state-sponsored enterprises with an unfair advantage over Western investors; many Central Asian governments and leaders take umbrage when Western investment is conditioned on a country's advancement of democratic reform and human rights.⁴¹

Furthermore, Beijing could seek to leverage its position as the region's most influential and powerful economic actor to reap political benefits internationally. According to the International Crisis Group, for example, Kazakh analysts "allege that Chinese officials forge links with the top of the [Kazakh] political elite, so they can influence decisions at the highest levels."⁴² Beijing could use this influence to water down or derail U.S.-backed policy initiatives at the United Nations and other international arenas; undermine U.S. efforts to promote good governance, democracy, and human rights in Central Asia; and weaken U.S. efforts to combat terrorism, piracy, and other transnational threats in the region and around the world.

Moscow has publicly embraced China's emergence as a major player in Central Asia. Some argue that the two countries are keen to cooperate more closely in the wake of the Ukraine crisis. Economically, Russia is also benefiting from China's increasing oil and gas demand; during a visit by President Vladimir

Putin to Beijing this week, China may sign a multibillion-dollar deal to buy Russian gas, a further step in bilateral energy cooperation.⁴³

However, for the time being, China's growing presence in Central Asia appears to be a greater geopolitical concern for Russia than for the United States. China's entry into the Central Asian energy network has significantly weakened Russia's energy dominance – and political influence – in the region. The Chinese market provides Central Asian energy exporters with an alternative to Russia, and this is reinforced by China's investment in pipelines. For example, when the Central Asia-China Gas Pipeline came online, it broke Russia's stranglehold on Central Asian natural gas transit, empowering Turkmenistan to negotiate more favorable terms for the cost and volume of its exports to Russia.⁴⁴ Furthermore, China's energy engagement reduces Russia's access to cheap natural gas from Central Asia, which it has sold at a significant profit to Europe.⁴⁵

With the planned U.S. withdrawal of troops from Afghanistan later this year, Central Asia will no longer be at the center of U.S. global strategy, especially as Washington shifts its focus to the Asia Pacific and reduces its defense budget after more than 10 years at war. In the short term, these changes could exacerbate Central Asia's instability, leading to increased refugee flows, crime, and terrorism. In the long term, decreasing U.S. attention to Central Asia could cause the region to become the focus for great power rivalries. Therefore, as the United States transitions away from its decade-plus focus on Afghanistan, the Obama Administration should review and recast its policy toward Central Asia to ensure the United States remains fully engaged in the region.

Thank you for the opportunity to testify. I look forward to your questions.

Appendix 1: Select Major Chinese Energy Investments in Central Asia

Kazakhstan	<i>Kazakhstan-China Oil Pipeline:</i> CNPC and Kazakhstan's largest state-owned oil company, KazMunaiGaz, built a \$3 billion, 3,000 kilometer (km) pipeline from the Caspian Sea to Xinjiang in 2006. It has a capacity of 400,000 bpd.
Turkmenistan	<i>Central Asia-China Gas Pipeline:</i> CNPC built a \$7.3 billion, 7,000 km natural gas pipeline beginning in Turkmenistan and passing through Uzbekistan and Kazakhstan en route to China. The first part of the pipeline was completed in 2009 and currently has a capacity of 30 bcu per year, with a projection for 80 bcu per year by 2020.
Uzbekistan	<i>Central Asia-China Gas Pipeline:</i> China first imported Uzbek natural gas in 2012.
Kyrgyzstan	<i>Junda Oil Refinery:</i> Zhongda China Petrol Company opened Kyrgyzstan's first oil refinery in 2013, drawing on oil imported from Chinese fields in Kazakhstan. It has a capacity of 12,000 bpd.
Tajikistan	<i>Danghara Oil Refinery:</i> In April 2014, a Chinese company agreed to invest upwards of \$500 million in an oil refinery with a total expected capacity of 24,000 bpd.

Source: Compiled by Commission staff. Information is based on multiple sources.

Appendix 2: Central Asia Proved Oil and Natural Gas Reserves (2014 Estimates)

Country	Oil (billion barrels)	Gas (trillion cubic feet)	Oil Global Rank	Gas Global Rank
Kazakhstan	30	85	13	14
Turkmenistan	0.6	265	42	6
Uzbekistan	0.59	65	43	19
Kyrgyzstan	0.04	0.2	74	82
Tajikistan	0.01	0.2	80	82

Source: U.S. Energy Information Administration.

Appendix 3: China versus Russia Trade in Central Asia: Kazakhstan and Turkmenistan, 2012

	Total merchandise trade (US\$ bn)			China share (%)		Russia share (%)	
	Exports	Imports	Balance	Exports	Imports	Exports	Imports
Kazakhstan	\$ 86.4	\$ 46.4	\$ 40.0	17.9%	16.8%	7.3%	38.4%
Turkmenistan	\$ 11.2	\$ 10.4	\$ 0.8	69.5%	19.2%	1.6%	13.7%

Source: World Trade Organization, Eurostat

- ¹ Andrew Erickson and Gabriel B. Collins, "China's Oil Security Pipe Dream: The Reality, and Strategic Consequences, of Seaborne Imports," *Naval War College Review* 63:2 (Spring 2010): 90.
- ² Xinjiang shares 1,750 miles of borders with the Central Asian nations of Kazakhstan, Kyrgyzstan, and Tajikistan, among other countries. For the purposes of this testimony, Central Asia is defined as Kazakhstan, Kyrgyzstan, Tajikistan, Turkmenistan and Uzbekistan.
- ³ CCTV.com (English version), "Keynote Conference on Xinjiang Development Held," May 20, 2010. <http://english.cntv.cn/program/newsupdate/20100520/103909.shtml>.
- ⁴ This strategy, known as "March West," was put forward by Wang Jisi, a prominent Chinese scholar, in 2012. Wang Jisi, " 'Marching Westwards': The Rebalancing of China's Geostrategy," *International and Strategic Studies* 73 (October 2012). For analysis, see Yun Sun, *March West: China's Response to the U.S. Rebalancing* (The Brookings Institution), January 31, 2013. <http://www.brookings.edu/blogs/up-front/posts/2013/01/31-china-us-sun>.
- ⁵ Regional military engagement consists of delegation visits typically held alongside Shanghai Cooperation Organization meetings, occasional combined exercises focused on border security and counterterrorism concerns, security assistance, and professional military education.
- ⁶ Political movements for Xinjiang's independence or autonomy from Chinese rule have in the past attracted support from overseas Muslim groups, particularly in the Middle East and Central Asia. Beijing fears these groups could encourage or exacerbate what it refers to "separatist insurgencies" in Xinjiang. U.S.-China Economic and Security Review Commission, *Hearing on China and the Middle East*, testimony of Dawn Murphy, June 6, 2013.
- ⁷ U.S. Energy Information Administration, "China." <http://www.eia.gov/countries/cab.cfm?fips=ch>.
- ⁸ China National Bureau of Statistics, via CEIC database.
- ⁹ Murat Sadykov, "Turkmenistan Supplying Over Half of Chinese Gas Imports," *Eurasia Net*, August 6, 2013. <http://www.eurasianet.org/node/67356>.
- ¹⁰ "UPDATE 1-China and Russia still haggling over gas price ahead of Putin visit," Reuters, May 14, 2014. <http://www.reuters.com/article/2014/05/14/russia-china-gas-idUSL6N0004KE20140514>; Xinhua, "China targets increased gas imports from Turkmenistan," May 12, 2014. http://news.xinhuanet.com/english/china/2014-05/12/c_133328801.htm.
- ¹¹ "UPDATE 1-Uzbekistan aims to join China gas supply route in 2012," Reuters, May 17, 2012. <http://uk.reuters.com/article/2012/05/17/gas-uzbekistan-china-idUKL5E8GHC20120517>; Murat Sadykov, "Turkmenistan Supplying over Half of Chinese Gas Imports," *Eurasia Net*, August 6, 2013. <http://www.eurasianet.org/node/67356>.
- ¹² "China's Dec pipeline gas imports rise 20% on year to 2.56 Bcm," *Platts*, January 22, 2014. <http://www.platts.com/latest-news/natural-gas/singapore/chinas-dec-pipeline-gas-imports-rise-20-on-year-27855257>.
- ¹³ Alexandros Petersen, "Central Asia's New Energy Giant: China," *The Atlantic*, June 28, 2013. <http://www.theatlantic.com/china/archive/2013/06/central-asias-new-energy-giant-china/277338/>.
- ¹⁴ 2012 data is from the World Trade Organization statistics database. 2003 data is from China's General Administration of Customs.
- ¹⁵ Data from Eurostat. http://trade.ec.europa.eu/doclib/docs/2006/september/tradoc_113457.pdf.
- ¹⁶ FDI data taken from UNCTADStat. For this data only, Central Asia is comprised of Azerbaijan, Kazakhstan, Kyrgyzstan, Tajikistan, Turkmenistan, and Uzbekistan.
- ¹⁷ Alexander Cooley, *Great Games, Local Rules: The New Great Power Contest in Central Asia* (New York, NY: Oxford University Press, 2012), p. 91; Jim Nichol, *Central Asia: Regional Developments and Implications for U.S. Interests* (Congressional Research Service, March 2014), p. 17. <https://www.fas.org/sgp/crs/row/RL33458.pdf>.
- ¹⁸ China National Petroleum Corporation, "CNPC in Turkmenistan." <http://classic.cnpc.com.cn/en/cnpcworldwide/kazakhstan/>.
- ¹⁹ China National Petroleum Corporation, "CNPC in Turkmenistan." <http://classic.cnpc.com.cn/en/cnpcworldwide/kazakhstan/>.
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- ²¹ Rick Carew and Guy Chazan, "China Makes Big New Bet on Kazakhstan's Oil," *Wall Street Journal*, October 1, 2009. <http://online.wsj.com/news/articles/SB125428493302451733>.
- ²² Alexander Cooley, *Great Games, Local Rules: The New Great Power Contest in Central Asia* (New York, NY: Oxford University Press, 2012), p. 91.
- ²³ U.S. Energy Information Administration, *Country Analysis Briefs: Turkmenistan*, January 2012. <http://www.eia.gov/countries/analysisbriefs/cabs/Turkmenistan/pdf.pdf>.
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- ²⁶ Alexandros Petersen, "Central Asia's New Energy Giant: China," *The Atlantic*, June 28, 2013. <http://www.theatlantic.com/china/archive/2013/06/central-asias-new-energy-giant-china/277338/>.
- ²⁷ Marat Gurt, "China asserts clout in Central Asia with huge Turkmen project," Reuters, September 4, 2013. <http://www.reuters.com/article/2013/09/04/us-gas-turkmenistan-galkynysh-idUSBRE9830MN20130904>.
- ²⁸ Gabe Collins and Bo White, "Tajikistan's Gas Boom: Prosperity or Conflict," *The Diplomat*, June 5, 2013. <http://thediplomat.com/2013/06/tajikistans-gas-boom-prosperity-or-conflict/?allpages=yes>.
- ²⁹ Reuters, "Tajikistan invites CNPC to explore for oil and gas," June 5, 2012. <http://www.reuters.com/article/2012/06/05/tajikistan-china-idUSL5F8H579420120605>.
- ³⁰ Chris Rickleton, "Kyrgyzstan: China Muscles into Energy Market, Fueling Suspicion," *Eurasia Net*, March 20, 2013. <http://www.eurasianet.org/node/66716>.
- ³¹ David Trilling, "Kyrgyzstan Suspends Work at New Chinese Refinery," *Eurasia Net*, February 19, 2014. <http://www.eurasianet.org/node/68061>.
- ³² "Russian Energy Projects in Kazakhstan's Oil and Gas Sector" (New York, NY: Kazakhstan Chamber of Commerce in the USA). <http://kazcham.com/russian-energy-projects-in-kazakhstan%E2%80%99s-oil-and-gas-sector/>.
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- ³⁵ Eugene Tang, "China, Kazakhstan sign \$10 Billion Loans-for-Oil Agreements," Bloomberg, April 16, 2009. <http://www.bloomberg.com/apps/news?pid=newsarchive&sid=aRkoxDVwplmJY>.
- ³⁶ Erica Downs, *Inside China Inc.: China Development Bank's Cross-Border Energy Deals* (Brookings Institution, March 2011), p. 27. http://www.brookings.edu/~media/research/files/papers/2011/3/21%20china%20energy%20downs/0321_china_energy_downs.pdf.
- ³⁷ Erica Downs, *Inside China Inc.: China Development Bank's Cross-Border Energy Deals* (Brookings Institution, March 2011), pp. 54-55. http://www.brookings.edu/~media/research/files/papers/2011/3/21%20china%20energy%20downs/0321_china_energy_downs.pdf, Alex Anishyuk, "Turkmens Start Gas Supplies to China," *Moscow Times*, December 15, 2009. <http://www.themoscowtimes.com/business/article/turkmens-start-gas-supplies-to-china/396187.html>.
- ³⁸ For example, according to the International Crisis Group, Chinese companies have become targets of regular attacks in Kyrgyzstan in recent years. The most recent known attack occurred in October 2012, when media reported that protestors in northern Kyrgyzstan shut down work at the Taldy-Bulak Levoberezhnyi gold field, which was being prepared by China's Superb Pacific Ltd. Approximately 250 Chinese workers reportedly fled the site after the protest turned into a large-scale brawl. David Trilling, "Kyrgyzstan: Chinese respond to latest mine attack," *Eurasia Net*, October 30 2012. <http://www.eurasianet.org/node/66121>.
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- ⁴³ Associated Press, "China, Russia on Verge of Gas Deal," May 16, 2014. http://m.washingtonpost.com/world/europe/china-russia-on-verge-of-gas-deal/2014/05/16/969261c2-dcc8-11e3-a837-8835df6c12c4_story.html.
- ⁴⁴ Alexander Cooley, *Great Games, Local Rules: The New Great Power Contest in Central Asia* (New York, NY: Oxford University Press, 2012), p. 94.
- ⁴⁵ *Ibid.*

Mr. ROHRABACHER. Exactly 5 minutes.

Mr. SHEA. I timed it. I worked it. I worked it.

Mr. ROHRABACHER. Oh, you added so much to your credibility.

Mr. Santos, you may proceed.

**STATEMENT OF MR. CHARLIE SANTOS, CHAIRMAN,
UZBEKISTAN INVESTMENT GROUP, INC.**

Mr. SANTOS. Thank you, Chairman Rohrabacher and Ranking Member Keating. Former Soviet Central Asia is a bridge between Europe and China, Russia and the Indian Subcontinent consisting of Uzbekistan, Kazakhstan, Turkmenistan, Kyrgyzstan, and Tajikistan. It is a region more developed than its neighbors to the south. It straddles some very large energy reserves, most importantly natural gas with more than 400 trillion cubic feet, and significant volumes of oil. It also sits on vast mineral resources.

With the collapse of the Soviet Union at the end of 1991, our objective was to ensure the freedom of the newly independent countries of Central Asia. We saw in their significant energy resources the possibility of economic growth and development, and through accessing multiple markets economic independence.

We therefore pursued policies that focused on supporting private sector approaches to the development of their energy resources and the development of pipelines and transit corridors, seeing a modern version of Central Asia's historical experience as the heart of the Silk Road. Our interest in the region weakened, bordering on disengagement, as energy prices collapsed in the late '90s, the Taliban emerged in Afghanistan, and countries of Central Asia were slow in adopting transparent and investor-friendly policies and political reforms.

Our disengagement from Central Asia ended on September 11th, 2001, but our return was far more narrowly focused, namely, Afghanistan, Pakistan and later Iraq, never returning to the previous policy that saw the strategic importance of Central Asia, except as a logistics base of operation in Afghanistan. Afghanistan in a sense became the center of Central Asia for us.

While we sacrificed more than 3,000 lives and spent more than \$1 trillion on a nation-building exercise in Afghanistan, China sought to fill our policy vacuum, focusing on energy and pipelines in Central Asia, taking a page literally out of our policy playbook. So far they have constructed two pipelines, a third to be finished this year, and a fourth expected in 2017.

Our allies in Europe, with even more at stake in pursuing gas resources in countries like Uzbekistan and Turkmenistan, followed the U.S. lead even when it meant losing the possibility of greater energy supply diversification. This has led to greater dependence on Russian gas.

With the withdrawal from Afghanistan and growing East-West tensions, 2014 has demonstrated that our disengagement from Central Asia has left the U.S. and its European allies doubly exposed. The countries bordering on northern Afghanistan have become frontline states not only in the battle against extremism but also in aiding in the diversification of energy supplies for Europe.

The economic potential of Central Asia would not only help to stabilize Afghanistan through trade and possible transit of Afghan

energy but also would bring technical expertise embedded in common historical and cultural understandings.

The countries of Central Asia also present an opportunity to achieve the further diversification of energy, a diversification of European energy supply from Turkmenistan, Uzbekistan, Kazakhstan, and even Afghanistan. Strengthening Central Asia by encouraging economic development and investment in both energy and energy transit infrastructure and by building a more significant security relationship is the most cost effective strategy we have. Regional stability will emerge from a strong moderate and independent Central Asia, yet we seem to not have made this a priority.

Our future cooperation with the countries of Central Asia should support and promote economic development, investment and transparency as the best means of achieving stability. This is just as important as strengthening cooperation on matters of security. We clearly need a change in tone that is less strident and ideological, and more practical and based on common interests.

There are some key things I think we could do. One, renew support for the construction of the trans-Caspian pipeline which will link gas supplies from countries like Turkmenistan, Uzbekistan and Afghanistan as well as Azerbaijan on the other side of the Caspian Sea to Europe. Support economic capacity building, particularly the private sector, in developing better regulatory frameworks.

Support multilateral financial institutions and mechanisms to ensure financing for economically viable private sector projects. Support regional governments in their efforts to build a more transparent and investor-friendly business climate, which will, I believe, help unlock further investment.

Finally, there is no single way to solve Europe's energy dependency or bring stability to the region, particularly Afghanistan. But ignoring the importance of Central Asia, particularly the key countries that border Afghanistan and forgetting our initial insights about the region will surely make matters worse. When we ignore building broader strategic relationships, as we have during the past 12 years, we make our country and our allies more vulnerable.

The confluence of the Afghan withdrawal and growing tension in Europe this year is giving us a chance to refocus our policies to help build a stronger and more independent Central Asia. It is an opportunity we should not squander.

[The prepared statement of Mr. Santos follows:]

Charles Santos
Chairman, Uzbekistan Investment Group, Inc.
House Committee on Foreign Affairs
Subcommittee on Europe, Eurasia and Emerging Threats
Date: Wednesday, 21 May 2014;
Time: 2:00 p.m.
Title: The Development of Energy Resources in Central Asia

Former Soviet Central Asia is a bridge between Europe and China, Russia and the Indian Subcontinent, consisting of Uzbekistan, Kazakhstan, Turkmenistan, Kyrgyzstan, and Tajikistan.

It is a region more developed than its neighbors to its South. It straddles some very large energy reserves (and I have listed this in the appendix), most importantly natural gas, oil, metals, minerals and significant agricultural capacity.

With the collapse of the Soviet Union at the end of 1991, our objective was to ensure the freedom of the newly independent countries of Central Asia. We saw in their significant energy resources the possibility of economic growth and development and by having multiple markets for their energy, economic independence as well. We therefore pursued policies that focused on supporting private sector approaches to the development of energy resources, the development of pipelines and transit corridors—seeing a modern version of the Central Asia’s historical experience as the heart of the Silk Road.

Our interest in the region weakened, bordering on disengagement, as energy prices collapsed in the late 1990s, the Taliban emerged in Afghanistan and the countries of Central Asia failed or were slow in adopting transparent and investor friendly policies and political reforms.

Our disengagement from Central Asia ended on September 11, 2001 but our return was far more narrowly focused: namely, Afghanistan and Pakistan and later Iraq, never returning to the previous policy that saw the strategic importance of Former Soviet Central Asia, except as a logistics base for operations in Afghanistan. Afghanistan became the Center of our Central Asia for us.

While we sacrificed more than 3000 lives and spent more than a trillion dollars on a disappointing nation-building project in Afghanistan, China sought to fill our policy vacuum, focusing on energy and pipelines in Central Asia, taking a page out of our policy playbook.

Our allies in Europe with even a more at stake in pursuing gas resources in countries like Uzbekistan and Turkmenistan followed the US lead even when it meant losing the possibility of greater energy supply diversification.

With the withdrawal from Afghanistan and growing East-West tension, 2014 has demonstrated that our disengagement from Central Asian has left the US and its European allies doubly exposed: the countries bordering Northern Afghanistan have become frontline states not only in the battle against extremism but also in aiding in the diversification of energy supplies for Europe.

The economic potential of Central Asia will not only help to stabilize Afghanistan through trade and the possible transit of Afghan energy but

also through the value that the more advanced economies of Central Asia bring in terms of technical expertise combined with historical and cultural understanding that bordering countries bring.

The countries of Central Asia also enable another strategic objective: the possible further diversification of European energy supply from gas from Turkmenistan, Uzbekistan and even potentially Afghanistan.

Strengthening Central Asia by encouraging economic development and investment in both energy and energy transit infrastructure and by building a more significant security relationship is the most cost effective strategy we have.

Regional stability will emerge from a strong, moderate and independent Central Asia yet we seem to have not made this a priority. Our future cooperation with Central Asian countries should value economic development and the encouragement of the investment and transparency as the best way of achieving stability. This is just as important as cooperation on matters of security.

There are some key things we could do:

- Renew support for the construction of the Trans-Caspian Pipeline, which will link gas supplies from countries like Turkmenistan, Uzbekistan and Afghanistan to Europe;
- Support economic capacity building, particularly the private sector;

- Support multilateral financial institutions and mechanisms to ensure financing for economically viable private sector projects.
- Support regional governments in their efforts to build more transparent and investors legal framework as a way of unlocking further investment.

Finally, there is no single way to solve the Europe's energy dependency or bring stability to the region—particularly Afghanistan. But ignoring the importance of Central Asia, particularly the key countries that border Afghanistan and forgetting our initial insights about the region will surely make matters worse. When we ignore building broader strategic relationships, as we have during the past twelve years, we make our country and our Allies more vulnerable. The confluence of the Afghan withdrawal and growing tension in Europe this year is giving us a chance to refocus our policies to help build a stronger and more independent Central Asia. It is an opportunity we should not squander.

Mr. ROHRABACHER. Thank you very much, and only 2 seconds over, actually. All right. Mr. Merkel?

**STATEMENT OF MR. DAVID MERKEL (FORMER DIRECTOR,
EUROPE AND EURASIA, NATIONAL SECURITY COUNCIL)**

Mr. MERKEL. Thank you very much, Chairman Rohrabacher and Ranking Member Keating. It is a real honor be here. I appreciate the full testimony being submitted for the record, and in the time we have here will make an assertion, a couple of historical points and couple of recommendations.

The assertion is that Putin, while looking at the demise of the Soviet Union as the greatest catastrophe in the century, wants to at least be the gas station to Europe. And to be the gas station to Europe, to meet the market share and even increase the market share so it has leverage to draw a wedge between Europe and the United States on international issues, it needed to do a couple of things. It could have restructured its domestic gas market some time ago, it could have invested in some more difficult domestic fields, or it can have a stranglehold on Central Asian gas and its transit there.

Now Europeans, too often, and I think that this is one of the reasons behind Putin finally signing a deal that has been in discussions for 10 years, is the Germans in particular look at this issue, and we talk about diversifying global sources of energy, they talk about securing their source. They don't want their showers to go cold the way they did the two times that Russia shut off gas to Ukraine.

But the reality is, is that the gas in Central Asia will be developed. There is significant volumes there. And it is either going to be developed by Russia increasing its leverage that it has on Europe, or by China, or by and for the benefit of Europe, reducing the leverage that Russia has and reducing the power that China is going to have in Central Asia that was discussed before.

In this regard, I think there is a couple of things to keep in mind. We have a template for success in this, in the Baku-Tbilisi-Ceyhan pipeline, a pipeline that was the result of good, solid U.S. leadership behind President Bill Clinton and George W. Bush, a lot of input from both Houses of Congress, and of course the leadership in Azerbaijan.

There is a very solid example to follow. President Ilham Aliyev has taken the steps, him being outside of NATO, outside of the European Union, closer to Russia, he is still taking the steps to say that his gas is for Europe and to join with Barroso on the southern corridor.

So recommendations that I would put forward would be, one, again with the trans-Caspian pipeline. If we are going to decouple Central Asia from Russia or the growing influence in China, we need to join it up with Europe through Azerbaijan. Azerbaijan has been a very loyal partner to the United States on a great number of issues, and this would be a great opportunity to see the gas wealth on the east side of the Caspian join up with the west side.

We need to have a higher level of engagement in the region. No sitting President has visited the region. Through bilateral and multilateral engagements, the Presidents of China and Russia meet al-

most on a monthly basis. We shouldn't try and compete with that, we don't need to. But if we had a meeting in Baku with the President of Turkmenistan, Uzbekistan, Kazakhstan, and President Aliyev, it would send a clear signal that the United States is supportive not of bypassing Russia, not of punishing anybody, but a very strong message for competition.

Second, I think that it is important to recognize what Putin is doing here. He is taking a look at countries in the former Soviet Union and say, if you recognize that you are part of the Russian sphere of influence there is no problem, if you don't then we are going to create instability.

And when I was in government we did a lot following the Georgia War that was kind of undone by Sarkozy's lack of negotiating skills in the ceasefire agreement and the Russian reset. But we need to look at what Putin may be thinking about next after Crimea if he gets away with that as he thinks he will, and we need to focus more on U.S. leadership behind settling the Nagorno-Karabakh conflict in a peaceful manner that benefits both Azerbaijan by getting territory back that has been occupied, Armenia by getting out from under the Russian umbrella of its security, and I think that Putin would love to bloody the nose of Azerbaijan because it is the biggest vehicle to see the Caspian energy reach Europe.

Second, I think that some of the issues were talked about on the business side, OPEC should be reengaged to see whether there is a possibility that OPEC can do more to promote energy investment in Uzbekistan and Turkmenistan.

Congressman Keating, you mentioned governance, a very important issue. But we need to remember that unlike central Europe we don't have debt forgiveness, NATO membership, EU membership for these countries. We have to recognize that we always do ourselves good when we live up to our examples that our country was founded on, but we need to be informed by our own experience and recognize the neighborhood that they live in and talk about more than simply NGOs and democracy. Thank you.

[The prepared statement of Mr. Merkel follows:]

**The Development of Energy Resources
in Central Asia**

**House Foreign Affairs Committee
Wednesday May 21, 2014
2200 Rayburn HOB
Washington, D.C.**

**David A. Merkel
Senior Fellow, Atlantic Council
Dinu Patriciu Eurasia Center
Former Deputy Assistant Secretary of State for European
and Eurasian Affairs and Director for South and Central
Asian Affairs at the National Security Council**

Introduction

I would like to thank Chairman Rohrabacher, Ranking Member Keating and the Members of the House Foreign Affairs Subcommittee on Europe, Eurasia, and Emerging Threats for the opportunity to testify today. Further, I would like to commend the Committee for exploring this topic today. Too often, the issue of energy security, or Eurasia more broadly, tends to be discussed in reaction to steps planned and carried out by Moscow or Beijing. Events in Ukraine, as was the case with events in Georgia in 2008, require a well considered proactive approach.

In the time I have with you today, I would like to make an assertion, a couple of historical points and a few recommendations.

Russia as Gas Station to Europe

When I talk with our European allies about the leverage Moscow has because of Europe's dependence on Gazprom to keep their showers warm, they are often reluctant to pursue policies that result in the diversification of their hydrocarbon imports because they - notably Berlin - fear that Moscow would react negatively and their supply and other considerable business relationships would be interrupted. Europe receives more than 30 percent of its gas from Russia. While they see clearly the leverage that Russia has over the European Union as a supplier of energy, they often undervalue the fact that both suppliers and customers of energy have leverage. Even European Union documents, that my Russian interlocutors love to reference, conclude that Russia is more important to the European Union than the EU is to Moscow.

In Moscow any suggestion of competition of supply or transit would be characterized as anti-Russian or

reminiscent of a cold war mentality. These assertions would be made with quite a bit of verve as Putin relies on oil and gas as a political weapon in Europe, and among the countries of its former soviet empire.

Putin has determined that if the disillusionment of "Upper Volta with Nuclear weapons", as the USSR was often called, was the "greatest geopolitical catastrophe of the century", then he can regain at least regional greatness with a passive US Administration and an inward looking EU by being the gas station to Europe.

In order to maintain Russia's energy leverage over Europe, which as we have seen frustrates the likelihood of the EU implementing meaningful sanctions on Russia as a result of invading Ukraine, Moscow must control Central Asian gas and it's route to market. While it is clear that multiple sources and transit routes of hydrocarbons to market are preferable, this will not just happen. It requires a solution that is commercially viable; enjoys political leadership and vision as well as a corporate champion.

I should also point out here that there are other factors preventing European support for sectoral sanctions on Moscow. President Obama does not have the personal authority or relationships to gain Europe's consent to sectoral sanctions and Putin knows it. British Prime Minister David Cameron's concern for the City of London has him rejecting financial sanctions. French President Hollande's interest in the delivery of two war ships built for the Russian Navy, one remarkably named Sevastopol, call into question France's agreement to military sanctions along with Berlin's objection to Energy sanctions.

Baku-Tbilisi-Ceyhan Success

The Baku-Tbilisi-Ceyhan pipeline, transports one million barrels of oil per day from the capitol of Azerbaijan on the Caspian through the Republic of Georgia to the Turkish port of Ceyhan on the Mediterranean. Today, it is a commercial success that is contributing to one of the fastest growing economies, the most significant link between Europe and the Caspian Sea region and a most valuable tool in diversifying global sources of energy. This important link that assists Europe's energy needs and enhances the sovereignty of former Soviet Republics is the result of American leadership by two Administrations. Through a proactive policy developed and implemented by both the Administration of Bill Clinton and George W. Bush with significant input by both Houses of Congress and the political courage and leadership of the President of Azerbaijan, we see clearly what we are able to achieve when we have a strategic vision and see Russia as it is rather than as we wish it.

Central Asian Gas

Today the issue is more about gas than oil but again Central Asia and the Caspian region will play an important role. For Moscow to maintain its leverage over Europe, it must maintain or enlarge its share of the European gas market. It might have done so by restructuring its domestic gas market allowing for greater efficiencies resulting in increased volumes available for export or investing more in new - more challenging - domestic fields. As neither of these were pursued, choosing instead to spend its billions on corruption and a vanity project in Sochi, it must maintain a strangle hold on Central Asian gas and its transport to keep its European market share.

Kazakhstan, Uzbekistan and Turkmenistan are the three Central Asian Republics with significant hydrocarbon reserves. According to the International Energy Agency (IEA), Central Asia has five billion tons of recoverable reserves. While Kazakhstan has significant foreign investments developing its gas fields, the same cannot be said for Turkmenistan or Uzbekistan. This has been the result of a number of factors but most significantly because of the reluctance of the host governments to engage with foreign companies as a result of pressure from Moscow as well as corporate concerns about the investment climate.

Providing insulation to pursue our strategic interests

The Russian invasion of Ukraine and the annexation of Crimea despite international law, accepted norms of territorial integrity and even Russia's own signature on the 1994 Bucharest Memorandum, has brought to the front of the minds of decision makers the reality of Moscow's aggressive revanchist foreign policy. Countries in what Moscow calls its, "privileged sphere of influence" are concerned and looking to the United States for reassurance.

Despite previous U.S. Administration's National Security Strategy calling Central Asia an "abiding foreign policy priority" it is natural, given the retrenchment of the Obama Administration, for these countries in Central Asia to question if they have any other options. Yet, Putin showing his true colors along with his bare chest, provides an important opportunity in Central Asia and Europe. It would be wrong in the face of a successful Russian military invasion for the U.S. to ask countries in the region to do what is most difficult in their relationship with Moscow. However, if we articulate and pursue a clear policy that provides Central Asia and Europe benefits

that their leaders and citizens value, then we can be successful.

Prompt action is required

In 2008, following the invasion of Georgia, there was a similar moment. While the trigger for the conflict was less clear in the minds of many in Europe, the global financial picture was more dire and the Bush Administration, in which I served, was in its final months. Despite what CNN's Fareed Zakaria incorrectly asserts, the Bush Administration took significant steps to show Russia that the international community would not allow these actions and to discourage him from going on to Crimea - the principle concern at the time for Putin's next step - if Russia paid no price for its invasion of Georgia.

Regrettably, the lack of resolve and preparedness by President Sarkozy delivered a less than sound cease-fire agreement. What isolation and costs Russia would have incurred from the Georgian invasion were wiped clean as a result of the Obama Administration's "Russia reset." Europe was not going to implement something it did not have Washington's support for and Putin, seeing that he paid no price for Georgia, saw no reason not to move on to Crimea when he judged it in his interest.

Recommendations

Cross the Caspian: Link the hydrocarbon rich nations of Kazakhstan, Turkmenistan and Uzbekistan with Azerbaijan including support for a Trans-Caspian gas pipeline system.

If we are to decouple Central Asia from Russian dominance, we need to enhance its connection with Azerbaijan. Azerbaijan is the most dynamic country

with a growing economy in a region of great importance. The majority of the supplies exiting Afghanistan as a result of the U.S. drawdown transit Azerbaijan along the Northern Distribution Network. Baku has demonstrated itself as a valuable, stable and reliable partner in a difficult region addressing threats emanating from the Middle East and Central Asia.

Azerbaijan, Kazakhstan and Turkmenistan, along with Russia and Iran make up the littoral states of the Caspian Sea. Greater cooperation between Baku, Astana and Ashgabat, with the support of the U.S., would enhance the ability to exploit the resources of the Caspian sea and counter efforts by Moscow and Tehran to prevent a transit pipeline for gas from the west coast of the Caspian Sea from linking up with Baku's Southern Gas Corridor.

Despite pressure from President Putin, Azerbaijan President Ilham Aliyev has already demonstrated the vision, courage and leadership to resolutely state that Azerbaijan's gas is for European markets and pursue the Southern Gas Corridor. All that is needed for Central Asian gas to find markets in Europe is the ability to cross the Caspian sea.

This is preferable to the TAPI (Turkmenistan Afghanistan Pakistan India) Pipeline which, while it would have the benefit of bringing Afghanistan needed transit revenue, has several seemingly insurmountable obstacles. India, for its part, is focused on importing LNG - hopefully from the United States - to meet its growing energy needs.

Appoint a Special Envoy for Nagorno-Karabakh: Yesterday Georgia, today Ukraine, tomorrow Azerbaijan?

Putin's goal is to destabilize those former Soviet Republics that reject Moscow's claim of a "privileged sphere of influence" and choose to determine their own future. This is why Moscow is supporting separatists in Transnistria, recognized as independent the Georgian regions of South Ossetia and Abkhazia, annexed Crimea, are working to destabilize Ukraine's east and why they support Armenia's occupation of approximately 20 percent of Azerbaijan. We need to recognize that if what we once called the "frozen conflicts" left to us after the breakup of the Soviet Union are to be peacefully resolved, it will not be by following Moscow but by providing active diplomatic leadership. A peaceful resolution of the conflict in Nagorno-Karabakh is in the interest of Baku and Yerevan. It would return territory to Azerbaijan separated for over twenty years and provide Armenia an opportunity to climb out from under Moscow's stifling protection. It is only Russia that is the status quo actor.

The Obama Administration needs to be shaken out of their complacency and recognize that action is required to prevent an ever increasing possibility of armed conflict in Nagorno-Karabakh. Bloodying Azerbaijan - Putin's greatest vulnerability in controlling Caspian oil and gas - perhaps by claiming to come to Armenia's assistance, which is a member of Moscow's Customs Union and is under Russia's security umbrella, is all too possible.

As Secretary Kerry has demonstrated that Iran, Syria and North Korea will fill his calendar, what is required is a Special Envoy who has the respect of those in the region and is able to push Moscow for greater cooperation. It is my view that former Secretary of State Rice would be an ideal candidate. If not, the Obama Administration should pick someone of

similar gravitas, energy, established relationships and intellect.

Engage, uphold principles and moderate expectations:

OPIC

Putin's recent actions show that while the United States and the European Union want to do business in Central Asia, Moscow wants to own it. Now is the time to actively engage to develop Central Asian energy. The Overseas Private Investment Corporation's (OPIC) Central Asian activity should be reviewed with a view to supporting US exploration and production activities in Uzbekistan and Turkmenistan.

Elevate Engagement

No sitting US President has ever visited the region. This compared to Russian and Chinese leaders who, through regional and bilateral meetings, see the Presidents of Central Asia several times a year. We cannot compete with the amount of attention that Russia or China pay to the Central Asian leaders nor do we need to in order to demonstrate our interest. President Obama should travel to Baku, Azerbaijan to meet with President Ilham Aliyev and the Presidents of Kazakhstan, Turkmenistan and Uzbekistan to demonstrate our resolve to see energy supplies from the east coast of the Caspian joining with those on the west destined for markets in Europe.

Uphold Principles

The United States must always stand by our values, we never go wrong when we are an example to the world of the values that are at the very core of the formation of our country. When advancing these values internationally we do ourselves, our national interests, or our effectiveness no favors if we make proclamations without an understanding of the realities of the country, region and process within which the

recipient lives. In the case of Central Asia and the Caspian region, this includes neighbors such as Russia, China and Iran.

Realistic Expectations

Our policy should also be influenced by our own experience. We do not have the carrots for Central Asia and the Caspian region that we did for former eastern block countries. We need to come to terms with the fact that advancing free market principles, democratic principles or human rights advancement in Central Asia will not follow as quickly as was the case in Central Europe. Unlike in Central Europe, we do not have the incentive of NATO membership, EU candidacy, or debt forgiveness to leverage greater reform. Nor are they hearing only from the the US or Europe on the benefits of democracy. While Central Asia lacks a regional organization that includes the appropriate countries and promotes values and security, the European Union or NATO membership is not a possibility.

China Tilt: Russia-China tension in Central Asia.

It was the Great Game between the British Empire and Imperial Russia in the late 1800s that brought the Khanates of Khiva and Bukhara and British soldiers Connelly and Stoddard's experiences in the bug pit that defines this historic term. The Great Game for Central Asia in the future will be one between reactionary Russia and Mercantilist China. Russia has many advantages. Beginning with its history, not just the seventy years of the Soviet Union that linked Central Asia to Moscow but also earlier gains of Czarist Russia. Leaders, bureaucrats, academics and common people throughout Central Asia have had a link with Russia. Education, language, business, diaspora remittances and the ubiquitous Russian language television, point to the connections between Russia and the former Soviet Central Asian Republics. However,

the demographic reality of Russia demonstrates that in the future Moscow will not be the magnet it has been. Compare this with China. China, through the Shanghai Cooperation Organization (SCO) and directly, is investing large sums of money throughout Central Asia on huge road projects, rail projects, hydropower projects and other building projects. They are active in concessions on hydrocarbon projects including China's CNP acquisition of ConocoPhillips share of Kazakhstan's Kashagan oil field in the north Caspian.

China has demonstrated that its interests in Central Asia are economic, energy and to promote stability. It recognizes that it wants to have a common cause with the Central Asian Republics, principally Kazakhstan, to stifle separatist sentiments of the ethnic Uyghur in Xinjiang in its west. This is not to say that China's vast population superiority does not raise concerns of excessive demands following investment from Beijing among the leaders of Central Asia.

During the last decade in Central Asia, the only reason for Russia and China to work together in Central Asia, where they should be competitors, has been to counter what they see as US hegemony extending to military bases along their periphery.

We need not put ourselves in a position of having our interests in Central Asia characterized as countering Russia's historic role or China's growing role in the region. Nor, do we want to be seen as joining a compact deciding with other powers what is best for the government and people of Central Asia. We must have direct bilateral relationships to advance our national interest.

However, we need to be realistic. The Obama Administration is being questioned for pulling back from the strategically important Middle East, questions remain about what - if any - residual force will remain

in Afghanistan and President Obama's "Asia Pivot" has largely failed to materialize. There are real doubts in Central Asia about our future role.

We need to provide insulation for these countries when another power moves to serve its interest by bullying. When there are three powers, as Otto von Bismarck said, it is better to be in a group of two than to be the one facing the two.

Therefore, not in a way that could be described as a condominium, We should explore tilting towards China. China's foreign policy in Central Asia is much more benign as compared to Moscow who wants to and does meddle in their domestic elections and dictates with whom they can sign military and diplomatic alliances. In addition to moderating Moscow's appetite for influence in Central Asia, it may also have the benefit of not confronting China in Central Asia on its western border as the United States strengthens alliances - commercial, diplomatic and defense - to China's east and south.

Conclusion

I have lived, worked and traveled to this region for over two decades. I meet with the Presidents and Ministers in Central Asia. They are not looking to complicate their relationship with Russia, nor do they see themselves as Belarus or Armenia where their options are dictated by Moscow. They need to see that while our interests may be more limited, we will exercise leadership in pursuit of policy goals.

Hydrocarbon deposits in Central Asia and the Caspian region will be developed. The question is: will they be developed as an independent source adding to the options customers in Europe and Asia have or will they be exploited by Moscow enhancing Putin's ability to use energy as a political weapon.

It is wrong to suggest that Gazprom will not be a factor in Europe's energy mix into the future and we should not set as a goal this unachievable ambition. However, what is needed is for more market forces, more options to exist so when Putin picks up his energy tool for political purposes again, as he surely will, a proper exploitation of the Caspian resources along with US LNG and greater renewables will prevent it from being a useful weapon.

Mr. ROHRABACHER. And Mr. Mankoff?

**STATEMENT OF MR. JEFFREY MANKOFF, DEPUTY DIRECTOR
AND FELLOW, RUSSIA AND EURASIA PROGRAM, CENTER
FOR STRATEGIC AND INTERNATIONAL STUDIES**

Mr. MANKOFF. Mr. Rohrabacher and Mr. Keating, thank you very much for the opportunity to testify this afternoon.

While the United States has viewed the Caspian Sea Basin as a potentially new source of oil and gas, it has long fallen short of its apparent potential. In recent years though, Central Asia has produced and exported increasing quantities of both oil and gas though it is primarily China rather than Europe that has emerged as the region's principal customer and source of investment. While sales to China help the Central Asian producers lessen their dependence on Russian markets, they also limit prospects for transparency and political reform and represent a potential obstacle to Western influence in the region.

The United States has long recognized that pipelines to global markets would allow the countries of Central Asia to diversify their ties, create a new source of revenue for economies struggling with the collapse of the Soviet Union. The U.S. also believed that the presence of international energy companies could help transform the region's economies by introducing Western business practices, promoting transparency, and creating a new generation of specialists.

In the 1990s the target market was Europe, while today the United States is focused on markets in South Asia as part of its New Silk Road initiative promoting the construction of the so-called TAPI pipeline from Turkmenistan through Afghanistan to markets in Pakistan and India. Both in the 1990s and today, U.S. efforts have faced significant hurdles, perhaps most importantly, questions about commercial viability.

While the U.S. and its allies succeeded with much effort in bringing about the construction of the Baku-Tbilisi-Ceyhan pipeline, efforts to link this corridor to the east side of the Caspian have had limited success. Despite the recent agreement to construct a southern gas corridor from Baku to European markets, efforts to build a trans-Caspian pipeline have so far made little progress.

The major beneficiary of the struggles that both the United States and Russia have faced in this region has of course been China. And the reasons for China's success are not hard to grasp. It is a growing market with exponentially expanding energy demand. Moreover, China state-owned energy companies do not face the same financial constraints as Western firms. Flush with cash, comparatively insulated from the need to make an immediate return on their investments, they are less sensitive to political and economic risk and more responsive to political direction.

China's emergence into the Central Asian energy game represents both an opportunity and challenge. While the West has talked for two decades about new pipelines, China builds them and is pouring significant amounts of money into Central Asia in the process thereby reducing Russia's hold on the region's economies.

These new Chinese pipelines, moreover, promote cooperation and interdependency among the Central Asian states. Chinese infra-

structure, including but not limited to pipelines, supports U.S. goals of promoting economic and political diversification, integrating Central Asia into the global economy and promoting regional cooperation.

At the same time though the influx of Chinese state-directed investment does not come with the same demands for transparency and rule of law that Western investors seek. This in turn further entrenches Central Asia's corrupt, patrimonial political systems.

For now, Chinese investment also gives the Central Asian states an alternative to their dependence on Russia. In the future though the danger exists that these states will end up having traded dependence on Moscow for dependence on Beijing. Under the circumstances, U.S. options are somewhat limited. Above all, it remains important for the U.S. to emphasize its interest in remaining engaged in Central Asia even after the withdrawal from Afghanistan and in transitioning to a more economically driven relationship with the Central Asian states.

To the extent that the United States is serious about connecting Central Asian energy producers to global markets, it has an interest in these Chinese infrastructure projects. And while these projects need not be mutually exclusive of U.S. supported projects such as TAPI, the reality is that Beijing is offering the Central Asian states more concrete benefits and on a shorter time frame.

Central Asia's connection to the global economy through new pipelines, railways, roads and other infrastructure projects will also generate new opportunities for the region and for foreign companies looking to profit from Central Asia's location at the nexus of new transcontinental trade and transit links.

The U.S. can help this process by continuing its work with the Central Asian governments to promote a more favorable investment climate. The U.S. should also help the Central Asian states progress toward membership in the World Trade Organization which they view as a means of insulating themselves against economic coercion by their larger neighbors and a means of promoting their own economic transformations. At the same time, the United States should encourage more openness to non-energy investment which can help wean these countries off their dependence on natural resources and provide greater opportunities for non-Russian and non-Chinese companies.

The development of Central Asia's energy resources highlights what is perhaps the central challenge facing United States policy in the region. The U.S. if far away, has fewer direct tools available than either Russia or China. Nevertheless, the U.S. has an important role to play in ensuring that the Central Asian states remain fully sovereign and independent members of the international community.

It can best do this by remaining engaged including in Afghanistan, supporting the integration of this region with global markets through new transportation corridors regardless of which direction they go, and by continuing its efforts to make Central Asia a more attractive place to do business.

As the United States winds down its decade-plus of military operations in Afghanistan, it needs to place its engagement with the states of Central Asia on a new basis. Focusing on creating a more

favorable economic environment can help bring more foreign investment to the region, which in the longer term will be the major factor determining the extent to which the United States and its allies believe that they have a stake in Central Asia's development and prosperity. Thank you.

[The prepared statement of Mr. Mankoff follows:]



**Statement before the House Foreign Affairs Subcommittee
on Europe, Eurasia, and Emerging Threats**

***“THE DEVELOPMENT OF ENERGY RESOURCES
IN CENTRAL ASIA”***

A Statement by

Dr. Jeffrey Mankoff

Deputy Director and Fellow, Russia and Eurasia Program
Center for Strategic and International Studies (CSIS)

May 21, 2014

2200 Rayburn House Office Building

Testimony to U.S. House of Representatives Committee on Foreign Affairs, Subcommittee on Europe, Eurasia, and Emerging Threats, 21 May 2014

Dr. Jeffrey Mankoff, CSIS

Chairman Rohrabacher, Ranking Member Keating, and members of the Committee:
Thank you for the opportunity to testify this afternoon on The Development of Energy Resources in Central Asia.

While the United States has viewed the Caspian Sea Basin as a potentially major new source of oil and gas for world markets for more than two decades, the region long fell short of its apparent potential. Efforts to bring Caspian energy to European markets have faced a host of geographic as well as political obstacles, especially on the east side of the Caspian, that is, in the major Central Asian energy producers: Kazakhstan, Turkmenistan, and Uzbekistan. In recent years, Central Asia has produced and exported increasing quantities of oil and gas, though it is primarily China, rather than Europe that has emerged as the region's principal customer and source of investment. While sales to China help the Central Asian producers lessen the dependence on Russian markets they inherited from the Soviet Union, they also limit prospects for transparency and political reform, and represent a potential obstacle to Western influence in the region.

Central Asia is located far from major consumers in both Europe and Asia, and is hampered by complicated geography as well as its location in a difficult geopolitical neighborhood surrounded by Russia, Iran, and China. Beginning in the early 1990s, the United States sought to develop Central Asia's energy resources and transport them to global markets. In the 1990s, the target was Europe, with plans for oil and gas pipelines across the Caspian Sea to Azerbaijan, and thence through Georgia and Turkey to Europe. Today, the United States is focused on markets in South Asia as part of its New Silk Road initiative, promoting a the construction of the so-called TAPI pipeline from Turkmenistan through Afghanistan to markets in Pakistan and India. In both the 1990s and today, U.S. efforts have faced significant hurdles, perhaps most importantly, questions about commercial viability.

At independence, the Central Asian states were saddled with colonial economies oriented almost entirely to Russia. The United States recognized that pipelines to new markets in the West would allow these countries to diversify their ties and create a new source of revenue for

economies struggling with the consequences of the Soviet collapse. The United States also believed that the presence of international energy companies could help transform the region's economies by introducing Western business practices, promoting transparency, and training a new generation of specialists.

While the U.S. and its allies succeeded, with much effort, in bringing about the construction of the Baku-Tbilisi-Ceyhan (BTC) oil pipeline and the South Caucasus gas pipeline, efforts to link this corridor to the east side of the Caspian—that is, to Central Asia—have only had limited success. International energy companies including Chevron, ExxonMobil, ConocoPhillips, and others secured stakes in Kazakhstan's upstream in the early 1990s. These companies have helped Kazakhstan dramatically increase its oil production, which now exceeds 1.6 million barrels per day. They have also helped Kazakhstan access European markets, through both the privately-owned Caspian Pipeline Consortium (CPC) pipeline to the Russian port of Novorossiisk, and by barging oil across the Caspian to the BTC's terminus in Baku. The presence of these international companies in Kazakhstan's oil sector have also underpinned Kazakhstan's "multivector" foreign policy, which includes close cooperation with NATO and the European Union, alongside a strategic partnership with Russia and membership in the Russian-led Eurasian Economic Union.

Unfortunately, Kazakhstan's exports to Europe remain precarious. Russian pressure delayed expansion of the CPC pipeline for several years. Although an agreement is now in place, technical challenges continue to delay expansion. Meanwhile, high costs impeded the shipment of Kazakh oil through BTC for several years, and even now BTC is operating below capacity. International energy companies have also had less success gaining access to Kazakhstan's gas sector, which remains almost entirely state-owned, while growing state intervention in the oil sector has limited new commercial opportunities. These obstacles have proven less serious for China. Beijing opened the first phase of a new pipeline from Kazakhstan to western China (Xinjiang) in 2003, and continues expanding this pipeline's capacity, now set to reach 400,000 barrels per day.

Central Asia's other major energy producer is Turkmenistan, which is estimated to have natural gas reserves of more than 7.5 trillion cubic meters, fourth largest in the world. Far from major markets and with a very difficult investment climate, Turkmenistan struggled to attract foreign investment, especially before 2007. Unlike Azerbaijan or Kazakhstan, Turkmenistan has

never granted a Western firm an equity stake in its upstream, nor entered into any production sharing agreements with them. Consequently, it remained almost entirely dependent on Soviet-era pipelines to Russia for exports. Moscow used this dependency to dictate prices and acquire a stake in Turkmenistan's gas industry. Cheap Turkmen gas also contributed to Russia's ability to exert leverage over Ukraine. Much of this gas was sold by corrupt intermediaries to Ukrainian consumers at a significant markup, contributing to Ukraine's accumulation of massive debts to Russia.

The United States has long supported construction of a gas pipeline across the Caspian Sea to bring Turkmen gas to Europe. The recent agreements to construct a Southern Gas Corridor from Baku to European markets have again raised the issue of this trans-Caspian pipeline. Thus far, Western efforts to promote a trans-Caspian pipeline have made little progress. Russia and Iran argue that no pipelines can be built until the five littoral states resolve their territorial claims in the Caspian, effectively giving Moscow and Tehran veto rights, backed up by their growing naval capabilities in the Caspian. Azerbaijan also remains reluctant to see Turkmenistan emerge as a competitor or allow Turkmen gas into its pipelines.

With the global financial crisis depressing demand, Russia attempted in 2008-09 to scale back its purchases of Turkmen gas. Particularly after a pipeline explosion in April 2009, sales to Russia plummeted. The main beneficiary proved to be China, which very quickly moved to secure Turkmenistan's resources for itself. The first branch of a new gas pipeline from Turkmenistan to China opened in late 2009, a little more than three years after the original framework agreement was signed. A second branch (Line B) opened in 2010, a third branch (Line C) is now under construction, and an agreement to build a fourth branch (Line D) was signed last autumn.

In 2013, China imported around 20 billion cubic meters of Turkmen gas, close to double what Russia imported. Once all the currently planned pipelines are in place, China aims to import 65 billion cubic meters of Turkmen gas by 2016. Of course, Russia remains a central player as well; Russian gas monopoly Gazprom took a controlling stake in Kyrgyzstan's gas industry in December (something it has long been seeking to do in Ukraine as well), and remains Kazakhstan's major outlet to global markets given the challenges facing CPC and BTC.

The reasons for China's success in Central Asia are not hard to grasp. China's state-owned energy companies do not face the same financial constraints as Western firms. Flush with

cash and comparatively insulated from the need to make an immediate return on their investments, these firms are less sensitive to political and economic risk. They are also more responsive to political direction. One of the main reasons the U.S. has failed in its efforts to build a trans-Caspian pipeline, and that TAPI faces an uphill battle now, is the difficulty of convincing private sector companies to risk their shareholders' money on such complex, politically risky projects that face uncertain returns.

Chinese energy companies are also easier for the Central Asian governments to deal with, since they operate essentially as branches of the Chinese state. Rather than negotiating with a squabbling consortium of Western firms, the Central Asian leadership can simply sign a deal with its Chinese counterpart, knowing that Beijing will follow through on its commitments. Chinese companies are also less disruptive to the political status quo, and more comfortable operating in the challenging political environment some of these countries represent.

For the United States, as well as the region itself, China's emergence into the Central Asian energy game represents both an opportunity and a challenge. Chinese investment has helped bring vast new quantities of oil and gas online, especially in Turkmenistan. While the West has talked for two decades about new pipelines, China is building them, pouring significant sums of money into Central Asia in the process, and reducing Russia's hold on the region's economies. These new Chinese pipelines, moreover, promote cooperation among the Central Asian states themselves. If and when Line D is constructed, all five Central Asian states will have Chinese-built gas pipelines crossing their territory, giving the three energy producers (Kazakhstan, Turkmenistan, and Uzbekistan) access to the lucrative Chinese market, while bringing new resources to energy-deprived Kyrgyzstan and Tajikistan. Chinese-built infrastructure, including but not limited to energy pipelines, supports the United States' goals of promoting economic and political diversification in Central Asia, integrating the region into the global economy, and promoting regional cooperation.

At the same time, the rapid influx of state-directed Chinese investment does not come with the same demands for transparency and rule of law that Western investors seek, which in turn risks further entrenching Central Asia's corrupt, patrimonial political systems. It also portends greater Chinese political influence in the region, potentially complicating efforts to maintain a balanced geopolitical environment. For now, Chinese investment gives the Central Asian states an alternative to dependence on Russia, allowing them to balance more effectively

between their two giant neighbors. In the future however, the danger exists that these states will end up having traded dependence on Moscow for dependence on Beijing. This prospect would be particularly worrying in the admittedly unlikely event that a true Sino-Russian strategic axis emerges.

With the United States pulling its forces out of Afghanistan, it is no secret that many in Central Asia fear the U.S. will turn its gaze away from the region, which has already seen the closure of a U.S. base in Kyrgyzstan and a reduction in U.S. foreign assistance across the board.¹ After 2014, a larger share of the United States' presence and influence in the region will have to come from the private sector; while Central Asia's governments would like to see U.S. trade and investment in fields other than energy, for the foreseeable future, energy will remain the most promising target for foreign investment. Yet the same problems that have bedeviled U.S. companies for two-plus decades are not going away either.

Under the circumstances, the U.S. has somewhat limited options. Above all, it remains important for the U.S. to emphasize its interest in remaining engaged in Central Asia even after the withdrawal of combat forces from Afghanistan, and in transitioning to a more economically driven relationship with the Central Asian states.

That said, the U.S. should acknowledge that projects requiring private investment but lacking commercial viability or facing excessive political risk are unlikely to get built. To the extent that the United States is serious about connecting Central Asian energy producers to global markets, it has an interest in the success of Chinese-built infrastructure projects, including Central Asia's new gas pipelines. While these projects need not be mutually exclusive of U.S.-supported projects such as TAPI, the reality is that Beijing is offering the Central Asian states more concrete benefits on shorter time-frame, and it would be counterproductive from the perspective of U.S. influence, not to mention the wellbeing of Central Asians themselves, for the U.S. to attempt to impede them.

Central Asia's connection to the global economy through new pipelines, railways, roads, and other infrastructure projects will also generate new opportunities for the region, and for foreign companies looking to profit from Central Asia's location at the nexus of new transcontinental trade and transit links. That said, the U.S. can help by continuing its work with the Central Asian governments to promote a more favorable investment climate, which can in

¹ <http://gbk.eads.usaidallnet.gov/query/do>.

time make the region more appealing to the Western firms capable of offering the region not just investment, but also modern business practices and opportunities to develop their human capital.

The U.S. should also focus on helping the Central Asian states progress towards membership in the World Trade Organization. Right now, Kyrgyzstan and Tajikistan are WTO members, while Kazakhstan is getting closer. Kazakhstan views WTO membership as a way to insulate itself against potential economic coercion by its larger neighbors, as well as a means of promoting its own domestic economic transformation.

The development of Central Asia's energy resources highlights what is perhaps the central challenge facing United States policy in the region, namely that the U.S. is far away, and has fewer direct tools available than nearby Russia and China. Nevertheless, the United States has an important role to play in ensuring that the Central Asian states remain fully sovereign and independent members of the international community. It can best do this by supporting their integration with global markets through new transportation corridors—regardless of whether these corridors run east to China, west to Europe, or south to India—and by continuing its efforts to make Central Asia a more attractive place to do business.

As the United States winds down its decade-plus of military operations in Afghanistan, it needs to place its engagement with the states of Central Asia on a new basis. Focusing on creating a more favorable economic environment can help bring more foreign investment to the region, which in the longer term will be the major factor determining the extent to which the United States and its allies believe they have a stake in Central Asia's development and prosperity.

Mr. ROHRABACHER. I will have to admit that this panel has been more accurate in the formulation of their time than just about anyone I have ever witnessed, so it gives me hope for the future.

But for right now I will yield to the ranking member so he can proceed with his questions, just in case there are votes, and then I will let Mr. Marino has joined us, after that, so that I will then be the last to ask the questions. So go right ahead.

Mr. KEATING. Thank you, Mr. Chairman.

I was just curious on one issue. I didn't hear it directly touched upon. But to what extent, if any, has Russia's energy giant, Gazprom, locked up oil and natural gas supplies from Central Asia, and to what extent can the major energy producers in the region, Kazakhstan, Turkmenistan, Uzbekistan, move oil and gas supplies to markets other than Russia? Anyone could jump in if they would like.

Mr. MERKEL. There is still, I mean with regard to who owns the molecules and the transit routes, there is still opportunities to bypass Russia. Really, Uzbekistan and Turkmenistan, even though Turkmenistan is the largest importer of gas to China, there is still a lot of recoverable reserves in both places.

I would differ from my colleague here, where I think that the heading south there is too many obstacles. The advantage of transit revenues to Afghanistan is attractive, but I think that we ought to re-engage on bringing it on through the Caspian to link up with the southern corridor.

Mr. SANTOS. There are basically right now two ways to get the gas out. One is through Russia and the other is to China. Two pipelines are already built, the third one is being finished this year. The other options are trans-Caspian as we discussed, TAPI to the south.

I actually spent 3 years on TAPI negotiating the transit agreements with the different Afghan groups in the late 1990s. My feeling about TAPI, and I tend to agree with David, my feeling about TAPI is it is much more complicated. The market in Europe is bigger. The obstacles, I believe, are less compared to what you have to do to get the pipeline through Afghanistan and these Taliban areas, great drug production, instability, and you are basically bringing it to Pakistan, and then Pakistan, you need the market in India to really justify the cost of that pipeline.

But do the Indians want the Pakistanis to control their gas? I mean we are talking about this in another sense in terms of Russia controlling, and I think India would have a harder time with that and I think they have actually refocused in terms of looking at energy sources in other areas. But those are the ways. And so I think from a policy point of view it seems to make most sense to look at the trans-Caspian and look at trying to get the gas to Europe.

Mr. KEATING. I think you touched on another question I had with India, Pakistan and Afghanistan which presents a whole new set of issues. But now the Russian opposition, getting to the trans-Caspian pipeline, could impede its construction at least in the short or medium term. This could force Turkmenistan to look for alternate land routes to ship its gas to Europe.

One potential route may be through Iran's central gas transportation trunklines into Turkey. Is Turkmenistan interested, do you

believe, in the European market in this respect and what are the issues surrounding this type of rerouting? Would the current Western sanctions in Iran, for instance, prevent Turkmenistan from exploring this option? What do you think in regard to the trans-Caspian pipeline in that respect?

Mr. MANKOFF. Yes. With regard to the trans-Caspian issue and Russian pressure, this is certainly one of the major concerns. Russia has used its leverage over all of the other littoral states to essentially argue that no trans-Caspian infrastructure can be built until the territorial disputes are resolved. And of course that means Russia views itself as having a veto over this issue.

At the same time because of Russian military and naval capacity there is obviously an ability to physically prevent or disrupt construction of projects that Russia does not support. With regard to the Iranian route, there is of course interest on the part of the Turkmen who do sell some gas to Iran already. Obviously there would have to be a lot done in order to reintegrate Iran into the international system in order to make that a viable way to go. And that of course also depends on what the Iranians do.

Mr. KEATING. Anyone else want to answer?

Mr. SANTOS. All I would add to that is that any given sanctions and given the political situation, I think an Iranian option is a very remote one, and one that to me doesn't seem like you would be able find the investors that would really want to take that risk. I would say regarding the Russian obstruction in the Caspian that is correct.

But the situation that we are now facing is Russia is now creating alternative markets for itself. It is not just selling to Europe but it is selling to China. So I would find it a very interesting conversation for the Central Asian governments to have with Russia and with the U.S. and Europe behind them talking about free access, when they are wanting it for themselves but they don't seem to allow other countries in Central Asia to have it. I think that is a harder position to stand behind.

Mr. KEATING. Do any of you want to just comment briefly on the announcement with the \$400 billion plan? Just what your thoughts are, speculations might be or—

Mr. SHEA. I think the key thing there is the price. And I think basically it is a sign of Russian weakness. They need to diversify. They need the money. Their economy is basically flatlined. The Chinese had the leverage. So for me I would look at, it has been going on, they have been haggling about it for 10 years or so, and to me the key thing is price.

If the Russians got a good price, then I am inclined to view it as more of a geo-strategic gift from the Chinese to the Russians for some reason. But that is what I would look at is price.

Mr. KEATING. David, and what about the timing of this?

Mr. SANTOS. Well, your timing was perfect for the hearing.

Mr. MERKEL. I think it is a wedge issue. There is a lot of reasons why Europe will not go into sectoral sanctions, but Germany has a big role in the EU and its economic and energy relationship with Russia is significant. And Moscow wants Europe and Germany to focus on maybe their Russian gas is not all that secure. I think that is a canard. I think the agreement is kind of like an NFL sign-

ing thing. There is always like a massive amount of money, and then by the end of the career the guy didn't make that much money.

Mr. KEATING. Thank you. Should we ask Tom?

Mr. ROHRABACHER. Mr. Marino?

Mr. MARINO. Sure. Thank you, Chairman.

Mr. Shea, I would like to start with you please. Am I correct in stating that if we are talking about development of resources in Central Asia, the United States would be expected to play a role in that whether it is through technology or just outright economic support?

Mr. SHEA. That is correct. One of the things that I think is appealing to the Central Asian governments is the Chinese no-strings-attached approach. When President Xi showed up in September, one of the things he emphasized at his speech in Kazakhstan was we respect your territorial sovereignty and your internal affairs so we don't bug into that. We don't tell you how to run your own show. And I think that is very attractive to a lot of the Central Asian governments.

Mr. MARINO. Mr. Santos, with the instability in Central Asia and the economic woes concerning the EU, would it not be beneficial for the U.S. to continue to developing its infrastructure in the United States and shipping LNG overseas?

Mr. SANTOS. I don't think that there is any single solution. So I think energy supply and energy shortages or energy dependency in Europe can be solved by a number of different avenues. It would be one.

Mr. MARINO. Even with Russia doing what it has done, either turning off or jack the price up, we have no idea what China is going to do under those circumstances. Wouldn't it be more of a stable atmosphere instead of the United States giving money, technology, we have enough here in the United States? I live right in the middle of Pennsylvania and Marcellus Shale, the largest deposit in the country, enough to serve the United States for 100 years or more and ship it overseas. So Mr. Merkel, what—

Mr. ROHRABACHER. I vote yes.

Mr. MARINO. Mr. Merkel, not only would it generate jobs and stimulate the economy here by leaps and bounds, but wouldn't there be more political stability under that scenario?

Mr. MERKEL. I think that exporting LNG in volume would be the single best thing that we could do to remove the scarcity of gas in Asia, really take a concrete step in the Asia pivot, remove energy as a tool from Putin. Now gas doesn't travel as well as oil does, but there is still a global market. And in India, one of the reasons they are not looking at TAPI anymore is they are looking to import LNG hopefully from the United States.

Mr. MARINO. Look, we can put a man on the moon and we can transplant a heart, and we can figure out a way to transport LNG from the U.S. overseas.

Mr. MERKEL. I think there would be a lot of swaps with Qatar. I think that is the way it would work out. It would go to the U.K. and there would be swaps. We can definitely ship it.

Mr. MARINO. Mr. Mankoff, any opinion you would like to state pursuant to my questions of why should the United States take

part in this investment as opposed to developing its own resources and selling them? Both from an economic standpoint and from a geopolitical standpoint.

Mr. MANKOFF. Yes. I think the answer to Europe's energy security woes is all of the above. And so the development of U.S. shale gas resources is certainly something that can contribute to that but I don't think it is a panacea and I don't think it is going to happen all at once.

Mr. MARINO. But what I see the panacea being is the United States developing the oil deposits that it has, the coal deposits that it has, and of course with the LNG in the safe way we do. We do it the safest in the world. We do it the cleanest in the world. I would think that the -stan countries, Europe, would certainly like doing business with the United States more so than it would the Middle East or Russia or China for that matter. And with that I yield back.

Mr. ROHRABACHER. Well, thank you very much, and the chairman will now take his 5 minutes. And we are about 10 minutes into a vote and in 5 minutes we will be adjourning the hearing and we will be going to vote.

Just my colleague's focus on LNG, just a thought. And if indeed LNG production for the United States is utilized to provide our European allies and others with the gas resources that they need, to the degree that they are dependent on that is also the degree to which Russia then plays a stronger role in Central Asia.

So if indeed you have oil and gas coming from Central Asia, it would tend to connect Central Asia with Europe, which is perhaps something we would want to encourage. Not to say—but let me just note, and first of all I would like the panel's opinion on that. And second of all, let me just note from the chair's opinion this is not aimed just at Russia by the way.

That the chair happens to believe as was noted when I said I would vote for your proposal that any increase in the supply of oil and gas anywhere in the world uplifts humankind. It provides thus because it increases by its very nature the wealth that exists in the human condition. And thus even if they get their oil from LNG, from Pennsylvania which is a good thing, or from Central Asia that too would be a good thing at least from this congressman's opinion, and does the panel have any comment on that? Yes, Mr. Santos?

Mr. SANTOS. I would agree. I think Central Asia, the stability of Central Asia is about the stability of Afghanistan to a large extent, and the fact is that the neighborhood is not a great neighborhood. Iran on one side, Pakistan on another. Why don't we want to be strengthening the countries that could actually help us stabilize the country that we just spent \$1 trillion on and sacrificed a number of American lives to free and keep free from the Taliban?

So I think you have to see it in a broader strategic way. I would agree with that. And that helping Central Asia helps us, it doesn't hurt us.

Mr. ROHRABACHER. And we are not talking about aid. Let me note.

Mr. SANTOS. We are not talking about aid. These are actual assets that can be developed. They don't require—

Mr. ROHRABACHER. Yes, sir. Mr. Mankoff?

Mr. MANKOFF. I think the stability of Central Asia is really about Central Asia, and there is another reason for the U.S. to be involved in the energy development in these countries. By promoting investment and economic development, that I think is the most secure path toward long term stability and development.

And at the same time given the neighborhood where these countries exist at the nexus of Russia, China, Afghanistan, Pakistan, by being involved economically the U.S. can ensure that it has a voice in these countries and it has influence which can help it manage its relationships with those other surrounding powers.

Mr. SHEA. There is a term, familiarity breeds contempt. Ten years ago the Southeast Asian countries were welcoming Chinese investment. Now a lot of them are coming to the United States and say come back. Burma, we want to have a strong relationship with you.

So I could see the Central Asian countries, China is sort of displacing Russia economically, but I could see a few years down the road them saying, where is the United States? Because the Chinese, typically these large state-owned companies throughout the world bring a lot of negative things.

Mr. ROHRABACHER. Go right ahead.

Mr. MERKEL. Yes, it is not needed, investment is not needed. Political leadership from the West is needed. This will be done with private sector money. It is political leadership that is needed. And just as the Baku-Tbilisi-Ceyhan pipeline linked to Europe, Azerbaijan, we need to cross the Caspian so to the benefit of Europe but also for greater prosperity and stability in Central Asia.

Mr. ROHRABACHER. I have been noted that we have 5 minutes left for the members to go and vote. Let me just sum up today's hearing and that is to say that number one, we appreciate the panel. You have given us food for thought, and I think that those of us who participated will have, we have some new information and ammunition for making these decisions.

I personally think this last talk that we just had, because I brought up the issue of course, was most significant in that yes, let us be aware that China and Russia and how their influence on Central Asia and what is good for them is something we have to put into our equation. But as we create a real global economy, Central Asia is playing a pivotal role. That is the center of the universe.

And if we let the center of the universe be dominated by Russia or, and by China, by not utilizing a commercial interaction based on their natural gas and oil we are leaving that center of the universe to be in a commercial relationship with those powers rather than the western democracies and the United States. So I prefer to, as I say, look at this not as an attack on Russia and China, but setting up a global type of system that will improve the life of everybody.

So thank you all very much. This hearing is adjourned.

[Whereupon, at 2:59 p.m., the subcommittee was adjourned.]

A P P E N D I X

MATERIAL SUBMITTED FOR THE RECORD

**SUBCOMMITTEE HEARING NOTICE
COMMITTEE ON FOREIGN AFFAIRS
U.S. HOUSE OF REPRESENTATIVES
WASHINGTON, D.C. 20515-6128**

**Subcommittee on Europe, Eurasia, and Emerging Threats
Dana Rohrabacher (R-CA), Chairman**

May 20, 2014

TO: MEMBERS OF THE COMMITTEE ON FOREIGN AFFAIRS

You are respectfully requested to attend an OPEN hearing of the Committee on Foreign Affairs to be held by the Subcommittee on Europe, Eurasia and Emerging Threats in Room 2200 of the Rayburn House Office Building (and available on the Committee website at www.foreignaffairs.gov):

DATE: Wednesday, May 21, 2014

TIME: 2:00 p.m.

SUBJECT: The Development of Energy Resources in Central Asia

WITNESSES: The Honorable Dennis Shea
Chairman
U.S.-China Economic and Security Review Commission

Mr. Charlie Santos
Chairman
Uzbekistan Investment Group, Inc.

Mr. David Merkel
(Former Director, European and Eurasian Affairs on the National Security Council)

Mr. Jeffrey Mankoff
Deputy Director and Fellow
Russia and Eurasia Program
Center for Strategic and International Studies

By Direction of the Chairman

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COMMITTEE ON FOREIGN AFFAIRS

MINUTES OF SUBCOMMITTEE ON Europe, Eurasia, and Emerging Threats HEARING

Day Wednesday Date May 21, 2014 Room 2200

Starting Time 2:07pm Ending Time 2:59pm

Recesses ☐ (____ to ____) (____ to ____) (____ to ____) (____ to ____) (____ to ____) (____ to ____)

Presiding Member(s)

Rep. Rohrabacher

Check all of the following that apply:

Open Session ☒

Executive (closed) Session ☐

Televised ☐

Electronically Recorded (taped) ☒

Stenographic Record ☐

TITLE OF HEARING:

The Development of Energy Resources in Central Asia

SUBCOMMITTEE MEMBERS PRESENT:

Rep. Keating; Rep. Marino

NON-SUBCOMMITTEE MEMBERS PRESENT: (Mark with an * if they are not members of full committee.)

HEARING WITNESSES: Same as meeting notice attached? Yes ☒ No ☐

(If "no", please list below and include title, agency, department, or organization.)

STATEMENTS FOR THE RECORD: (List any statements submitted for the record.)

TIME SCHEDULED TO RECONVENE _____

or

TIME ADJOURNED 2:59pm

[Signature]

Subcommittee Staff Director